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No. 01-463

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

FIOR D'ITALIA, INC.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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1. a. The question presented in this case is whether the employer's share of FICA tax on employee tip income must be determined by accumulating the result of individual audits of individual employees or may instead be based on a reasonable estimate of the aggregate amount of tips received by all employees. As we note in our opening brief, 26 U.S.C. 6201 broadly authorizes the Secretary to "make the inquiries, determinations, and assessments of all taxes * * * imposed by this title." Under that statute, courts have long upheld the agency's general authority to use reasonable estimating procedures in making tax assessments for "all taxes" imposed by the Internal Revenue Code, in-

cluding income, excise, and FICA taxes. See U.S. Br. 21-22 (citing cases); *id.* at 24-25 (citing cases).

It is telling that respondent does not dispute this basic proposition and does not contest the holdings of these cases. Instead, respondent contends only that the general authority to make assessments based on reasonable estimates of items of income is unavailable *for employer FICA tax calculations* because that authority is "specifically negated elsewhere" in the Code. Resp. Br. 36. In making that assertion, however, respondent fails to cite any statute that "specifically negates" the authority of the Service to make reasonable estimates of items of income in making employer FICA tax assessments—and no such statute exists.[1]

Respondent ultimately acknowledges that the tax provisions involved in this case impose "the employer's share of FICA taxes on an employee's tips [even] when the employee fails to report them and that such taxes can be assessed [on the employer] separate from, at a later date than, and regardless of whether the em-

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[1] Amicus American Gaming Association (AGA) claims that Section 6201 does not authorize the Service "to use any particular method of assessment, much less the method employed by the IRS here." Am. AGA Br. 12. In making this assertion, however, AGA ignores the established principle that the use of reasonable estimates in determining items of unreported income is a valid method of determining a disputed factual issue. U.S. Br. 21 (citing cases); see *id.* at 22-25. As the court emphasized in *Palmer* v. *IRS*, 116 F.3d 1309, 1312 (9th Cir. 1997), the fact that Congress has specified no particular methods or evidentiary burdens on the Commissioner in making an assessment reflects that the Commissioner "has wide discretion" in accomplishing that administrative task. See also *United States* v. *Janis*, 428 U.S. 433, 437, 441 (1976) (describing the calculation of a wagering excise tax assessment based on a reasonable estimate of wagers made); U.S. Br. 22 (citing additional cases).

ployee is audited, assessed, or even pays the tax * * * ." Resp. Br. 31 n.22.[2] The provisions involved in this case thus impose this tax directly, and independently, on the employer. They do not "specifically negate" or in any fashion depart from the general principle that assessments may be based on reasonable estimates of the items of income to which the tax applies. Accordingly, every court of appeals that has considered this issue, other than the court below, has correctly upheld the use of reasonable aggregate estimates of tip income in making assessments of the employer share of the FICA tax. See, *e.g.*, *Bubble Room, Inc.* v. *United States*, 159 F.3d 553, 566 (Fed. Cir. 1998); U.S. Br. 24 (citing cases).

b. Respondent errs in contending that estimates of items of income are permitted only when there has been "wrongdoing" by the taxpayer or when the taxpayer "is somehow at fault in a way that prevents the IRS from making an accurate determination of income." Resp. Br. 37, 39. Respondent points to no language in Section 6201 or any other provision of the Code that establishes such a condition on the use of reasonable estimates in making assessments. Respondent also fails to cite any case that holds that such a condition exists.

The condition that courts have actually imposed on the use of estimates in making tax assessments is that the assessment must not be "naked and without *any* foundation." *United States* v. *Janis*, 428 U.S. 433, 442 (1976). See also *Carson* v. *United States*, 560 F.2d 693,

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[2] Amicus AGA similarly acknowledges that, under these tax provisions, "an employer may be liable for its portion of FICA taxes even where an employee fails to report all tips." Am. AGA Br. 11.

696 (5th Cir. 1977) (the Service must provide "some factual foundation for its assessments"); *Gerardo* v. *Commissioner*, 552 F.2d 549, 554 (3d Cir. 1977) (assessment requires a "minimal" evidentiary foundation and the Service must "provide some predicate evidence connecting the taxpayer to the charged activity"); *DiMauro* v. *United States*, 706 F.2d 882, 885 (8th Cir. 1983) (same); *Weimerskirch* v. *Commissioner*, 596 F.2d 358, 361-362 (9th Cir. 1979) (same).

The assessment involved in this case is not "naked and without *any* foundation." Instead, for the reasons articulated previously (U.S. Br. 17-18), it reflects a reasonable estimate of tip income based on the information submitted by respondent to the IRS on Form 4070.[3] Even though respondent now purports to identify ways in which this estimate of tip income could be improved (Resp. Br. 18-19), it is far too late for such objections to be raised. In the courts below, respondent expressly and unequivocally elected *not* to dispute either the factual foundation or the reasonableness of the Service's aggregate estimate of tip income. J.A. 35; See U.S. Br. 18. Moreover, respondent offered no competing evidence to challenge the assessment. *Ibid.* Since the assessment had a rational basis, and since respondent offered no evidence to rebut the amount of taxes assessed, judgment should have been entered in the government's favor on both the refund and collection claims in this case. *Ibid.* See also *id.* at 10-14.[4]

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[3] There is no genuine dispute that a substantial underreporting of tips in fact occurred. See Pet. App. 2a n.2; U.S. Br. 18 n.16.

[4] Respondent does not now dispute that, even if the assessment *had* lacked a rational basis, the only consequence of an invalid assessment would be to shift the burden of persuasion to the

2. In arguing that the employer FICA tax may be determined only by adding up individual employee tips, respondent emphasizes (Resp. Br. 27-29) that 26 U.S.C. 3121(q) refers in the singular to tips received by "an employee in the course of his employment." Respondent fails to note, however, that Section 3121(q) does not impose the employer FICA tax. Instead, Sections 3111(a) and (b) furnish the statutory basis for the tax. 26 U.S.C. 3111(a), (b). These Sections do not impose the employer share of the tax separately on the wages earned by each discrete employee. They instead impose a single tax on the aggregate, qualified "wages" paid by the employer "with respect to having *individuals* in his employ." *Ibid.* (emphasis added).

The employer FICA tax imposed under Sections 3111(a) and (b) is computed as a percentage of "the wages (as defined in section 3121(a)) paid by [the employer] with respect to employment (as defined in section 3121(b))." 26 U.S.C. 3111(a), (b). Section 3121(a) defines the term "wages" collectively as "all remuneration for employment." 26 U.S.C. 3121(a). That formulation reflects that only a single assessment of the employer share of the FICA tax, made collectively for all wages that the employer pays, is required.

Respondent errs in relying on the fact that certain exclusions to the FICA taxes set forth in Section 3121(a) describe the excluded payments as being made

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government on the amount of taxes due in the collection case. See U.S. Br. 10-14. The documents in the record of this case reflect an undisputed underpayment of tax, for the credit card tips alone that are noted on respondent's reports exceed the tips on which respondent paid FICA tax. See Pet. App. 2a n.2; U.S. Br. 18 n.16. This evidence, by itself, would have supported a judgment that respondent owed more taxes than it reported and paid to the government. See U.S. Br. 14.

to an "employee" in the singular. Resp. Br. 27-28. The statute employs both the singular and the plural to describe various types of covered wage payments, referring to services from "employees" (26 U.S.C. 3121(b)(12)(B)), "service performed" for an employer (26 U.S.C. 3121(b)(7), (11), (15)), "service performed by foreign agricultural workers" (26 U.S.C. 3121(b)(1)), as well as to services provided by "an employee" (26 U.S.C. 3121(b)(9)) or "an individual" (26 U.S.C. 3121(b)(9), (13)). The emphasis that respondent would give to isolated singular, rather than plural, references in the statutory text is therefore inappropriate. Moreover, as several courts have pointed out (see, *e.g.*, *Bubble Room, Inc.* v. *United States*, 159 F.3d at 563-564; *330 West Hubbard Restaurant Corp.* v. *United States*, 203 F.3d 990, 995 (7th Cir. 2000)), any reliance on the singular or plural character of these isolated provisions violates the basic principle of statutory construction that:

> [i]n determining the meaning of any Act of Congress, unless the context indicates otherwise—*words importing the singular include and apply to several persons*, parties, or things; *words importing the plural include the singular* * * * .

1 U.S.C. 1 (emphasis added).

3. a. Respondent is incorrect in its contention that an aggregate assessment "conflicts with other FICA provisions and renders them meaningless." Resp. Br. 31. In particular, respondent errs in claiming that "wages" must be determined on a per-employee basis in order to give account to the "wages band" of Section 3121(a). As we explain in our opening brief, a reasonable estimate of tip income (and thus a valid assessment) may be adjusted or challenged by evidence

from the taxpayer that particular employees fell outside the wages band. U.S. Br. 17-18, 35 n.25. In this case, however, respondent affirmatively elected *not* to advance such a challenge and instead stipulated that, "[f]or purposes of this litigation alone, [t]axpayer does not dispute the facts, estimates and/or determinations used by IRS as a basis for its calculation of an amount of aggregate unreported tip income by all directly and indirectly tipped employees of the taxpayers collectively." J.A. 35. That stipulation was made when the case was in the district court and is, of course, binding on respondent at this stage of the case as well.

As a consequence of respondent's stipulation, there is no evidence in the record of this case to show that any of the evidentiary flaws of which respondent now complains are present. Moreover, the factual objections are directly inconsistent with respondent's evidentiary stipulation in the district court.[5] See U.S. Br. 34-39. As Judge McKeown emphasized in her dissent in the court of appeals, "the issue of accuracy is not before us, because [respondent] did not challenge the accuracy of the calculation * * * ." Pet. App. 33a.[6] Moreover,

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[5] In its brief in this Court (Resp. Br. 18-19), respondent makes several new factual arguments that have no support in the record. For example, respondent claims that the "IRS does not know to what extent customers use the tip line to procure cash[,] to purchase cigarettes or to pay for valet parking or * * * to feed video games." Resp. Br. 19. That sort of factual interjection is barred both by respondent's failure to provide any evidentiary support for its claim and by respondent's stipulation that it does not "dispute the facts, estimates and/or determinations used by IRS" in making the assessment involved in this case. J.A. 35.

[6] Respondent incorrectly suggests (Resp. Br. 18) that tip-sharing (or "tipping out") reduces the amount of tips meeting the definition of "wages" to be included in the employer's FICA tax base. The employer's liability under Section 3111 is based on total

even if a challenge to the accuracy of the assessment *had* been made in the district court—and had succeeded —it would not have provided a basis for "invalidating" the assessment. It would only have provided a basis for redetermining the amount of taxes that respondent must pay. *330 West Hubbard Restaurant Corp.* v. *United States*, 203 F.3d at 996-997; *Bubble Room, Inc.* v. *United States*, 159 F.3d at 567; see U.S. Br. 10-14, 34-35.[7]

b. Respondent also renews the assertion adopted by the district court that "[a]n employer cannot take advantage of th[e] tax credit [afforded by Section 45B of the Code] if the IRS assesses his FICA taxes on unreported employee tips in the aggregate." Pet. App. 47a. In rejecting this same contention in *330 West Hubbard Restaurant Corp.* v. *United States*, 203 F.3d at 997, the court of appeals correctly observed that the taxpayer's claim "is once again misplaced."

The Section 45B credit is available for employer FICA taxes on all employee tips *except* those that are applied (under 29 U.S.C. 203(m)) to satisfy the employer's minimum wage obligation. 26 U.S.C.

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remuneration, including tips, deemed to have been paid by him to *all* employees. The total remuneration of the employer's workers remains the same whether a directly-tipped employee retains all of his tips or passes a portion of them along to another employee.

[7] An "assessment is intended to be an estimate. It is expected to be rational, not flawless." *Dodge* v. *Commissioner*, 981 F.2d 350, 353 (8th Cir. 1992), cert. denied, 510 U.S. 812 (1993). Even if there were proof that the amount of the assessment were incorrect, that would not invalidate the assessment. "When a court is faced with an incorrect but otherwise valid assessment, the proper course is not to void the assessment * * * but to determine what, if anything, the taxpayer owes the government." *United States* v. *Schroeder*, 900 F.2d 1144, 1148 (7th Cir. 1990). See U.S. Br. 34-35.

45B(b)(1)(B).[8] The employer knows the amount of tips that are eligible for the Section 45B credit, for it knows whether (i) its direct wage payments to its employees meet the minimum wage obligation (in which case all tips are eligible for the credit) or (ii) its wage payments are less than the minimum wage (in which case the portion of tips in excess of those needed to satisfy the minimum wage are eligible for the credit). The suggestion that an aggregate determination of employee tips for purposes of assessing the employer portion of the FICA tax would somehow nullify the credit allowed by Section 45B is thus simply incorrect. *330 West Hubbard Restaurant Corp.* v. *United States*, 203 F.3d at 997; U.S. Br. 26-27 & n.19.

4. a. Respondent complains that employers are being put in the role of "monitoring" or "policing" employees' compliance with their tip reporting and FICA

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[8] The employer portion of the FICA tax for tips received by employees in "connection with the providing, delivering, or serving of food or beverages" (26 U.S.C. 45B(b)(2)) may be credited against the employer's income tax liability for the period in which the tax is paid. 26 U.S.C. 45B(a). The amount of this credit, however, is limited to the amount of the FICA taxes paid with respect to the portion of the tips received for such services *after* the federal minimum wage obligation for the employee has been satisfied. 26 U.S.C. 45B(b)(1)(B). The employer whose employees receive such tips may pay less than the minimum wage directly to a tipped employee, and may treat tips received by the employee as satisfying a portion of the statutory minimum wage. 29 U.S.C. 203(m); see U.S. Br. 26. The limited income tax credit afforded by Section 45B for the employer FICA tax on food and beverage service tipping thus does not, as respondent suggests (Resp. Br. 14), eliminate the tax consequences of the issue presented in this case. Moreover, the tax credit afforded by Section 45B does not apply to all other tipping situations, such as taxicabs, hair salons, or the host of other commercial activities to which FICA applies.

tax obligations. Resp. Br. 9, 21. In fact, however, respondent is being asked only to perform the same task that every other taxpayer must perform: to pay the taxes imposed on it under the Internal Revenue Code.

The possibility that respondent's employees may be evading taxes on part of their tips cannot excuse respondent's liability for the employer portion of this tax. Indeed, respondent has acknowledged that Section 3111 imposes "the employer's share of FICA taxes on an employee's tips [even] when the employee fails to report them." Resp. Br. 31 n.22. Respondent further acknowledges that the employer portion of the FICA taxes may be assessed on the employer "separate from, at a later date than, and regardless of whether the employee is audited, assessed, or even pays the tax" (*ibid.*). See also note 2, *supra*.

b. Respondent asserts that an employer has insufficient information to challenge a determination of employer FICA tax liability on unreported tip income when aggregate assessments are used. Resp. Br. 9, 38. That claim, however, is belied by the proceedings in the *Bubble Room* and *Morrison Restaurants* cases. As explained previously, issues of fact were properly raised to challenge the amount of an assessment in those cases and those issues were properly addressed and resolved in a timely fashion in proceedings before the agency and in district court. U.S. Br. 38. In the present case, however, respondent expressly elected not to raise such factual contentions in the courts below and is therefore precluded from raising them in this Court in the first instance. See *Id.* at 13 n.8.

5. Respondent errs in contending that aggregate assessments of the employer portion of the FICA taxes would frustrate the "core purpose of securing employee

benefits" (Resp. Br. 33). Respondent claims (Resp. Br. 8 n.3, 34) that this "core purpose" is revealed by a single sentence in the Senate Finance Committee staff explanation of Section 3121(q), which states that FICA taxes are collected from employers "on all tips which are credited for benefit purposes." Staff of Senate Comm. on Finance, 100th Cong., 1st Sess., S. Prt. 100-63, *Explanation of Provisions Approved by the Committee on December 3, 1987, for Inclusion in Leadership Deficit Reduction Amendment* (Comm. Print 1987).

The ambiguous statement in the Senate Finance Committee staff report on which respondent relies cannot, and does not, alter the requirements of the statute. As the *Bubble Room* Court stated: "[t]he statement that 'employers should be subject to tax on all tips which are credited for benefit purposes' must be read in context and with the understanding that the Senate staff was likely contemplating an ideal world in which employees report all of their tips." 159 F.3d at 564.

If resort to this staff report were thought appropriate, there is an unambiguous statement in the same report that is more germane to the question at hand: "Thus, employers must pay FICA taxes on the total amount of cash tips and other remuneration, up to the Social Security wage base." S. Prt. 100-63, *supra*, at 203. Accord, H.R. Conf. Rep. No. 495, 100th Cong., 1st Sess. 802 (1987); H.R. Rep. No. 391, 100th Cong., 1st Sess. Pt. 2, at 855 (1987). Indeed, as respondent has conceded (Resp. Br. 31 n.22), it is unquestionably the "total amount" of tips received by the employees, and not simply the amount of the tips that they report, that defines the employer's liability.

Moreover, social security benefits earned by an employee are not based on the taxes paid by the employer or the employee but on the covered wages

that are earned and reported. 42 U.S.C. 405(c)(2)(A). Employees receive Social Security earnings credit for tips that are reported either (i) in statements they submit to their employer pursuant to 26 U.S.C. 6053(a) or (ii) in statements they submit to the IRS on Form 4137. See *330 West Hubbard Restaurant Corp.* v. *United States*, 203 F.3d at 996; *Morrison Restaurants, Inc.* v. *United States*, 118 F.3d at 1530; SSA, Social Security Handbook § 1408 (when employee reports additional tip income on Form 4137, "IRS reports the additional income to [Social Security Administration for] credit[ing] to [the employee's] earnings record."). An employee fails to receive Social Security credit for tips earned only if he fails to report those earnings, as required by law. See *330 West Hubbard Restaurant Corp.* v. *United States*, 203 F.3d at 996; *Bubble Room, Inc.* v. *United States*, 159 F.3d at 565; *Morrison Restaurants, Inc.* v. *United States*, 118 F.3d at 1530.

Respondent similarly errs in asserting that there is a necessary linkage between the employer FICA tax on wages and the "social security benefits reasonably anticipated for the individual employee[s] of that employer." Resp. Br. 34. It has long been understood that no such linkage exists and that an imbalance in one direction or the other between taxes paid and benefits received is inevitable. See *Flemming* v. *Nestor*, 363 U.S. 603, 609-610 (1960). Respondent's argument reflects a misunderstanding of the relationship between FICA taxes and benefit payments. Social Security taxes collected from respondent are used to pay benefits to today's retirees; they are not linked in any fashion to the payment of benefits to respondent's current employees when they retire in the future. *Morrison Restaurants, Inc.* v. *United States*, 118 F.3d at 1530. See also *Flemming* v. *Nestor*, 363 U.S. at 609;

Bubble Room, Inc. v. *United States*, 159 F.3d at 564-565.

6. Respondent argues that the legislative history of various provisions that address the tax treatment of tips provides support for the contention that Congress has not authorized assessments based on a reasonable estimate of the aggregate amount of tips received by all of a restaurant's employees. Resp. Br. 1-14, 39-41. The history cited by respondent, however, does not support that contention.

When Congress responded in 1998 to restaurant industry complaints about the IRS practice of assessing an employer's liability for FICA taxes based on aggregate tip income—and about the decision of the Eleventh Circuit in *Morrison Restaurants* approving that practice—Congress elected not to prohibit the IRS from following that practice. Instead, Congress chose to direct IRS employees not to "threaten to audit any taxpayer in an attempt to coerce the taxpayer" to enter into a tip reporting agreement. See U.S. Br. 29 (quoting Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3414, 112 Stat. 755). By approving the concept of tip reporting agreements—under which the IRS agrees not to make an aggregate assessment in exchange for tip reporting actions taken by the employer—Congress necessarily acknowledged that aggregate assessments are generally permissible in the absence of such an agreement. See U.S. Br. 30.[9]

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[9] As Judge McKeown pointed out below, in enacting this statute Congress necessarily "*acknowledged the IRS's power to make aggregate calculations* of employer tax obligations" (Pet. App. 28a), for it would make no sense for a restaurant to enter into a tip reporting agreement in return for the Service's agreement not to do that which under respondent's theory it lacks authority

7. Respondent errs in urging (Resp. Br. 29-31) that the form of the notice and demand for payment of taxes that was issued by the Service in connection with the assessments involved in this case is at odds with various portions of the Internal Revenue Manual (IRM). This is an entirely new claim that was not raised or addressed either in the district court or in the court of appeals. It is therefore not properly presented in this case. *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970).

This new argument is unavailing in any event. Respondent claims that the Internal Revenue Manual directs the agency's auditors to require employers to prepare corrected wage statements for individual employees when the income attributed to them is adjusted, and to then transmit those corrected statements to the Social Security Administration. Resp. Br. 19, 30, citing IRM 4.23.7.13 and 4.23.9.9-10. Respondent asserts, without any supporting authority or analysis, that, in the absence of such corrected statements, a notice and demand for taxes (and a subsequent assessment of those taxes) may not be issued. Resp. Br. 30-31. That argument is defective in several respects.

(i) In the first place, the procedures for correcting W-2 wage statement forms are not part of the notice and demand procedures for the assessment of FICA taxes on unreported tip income. The provisions of the Internal Revenue Manual that deal with notice and

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to do. Indeed, "[i]t would be stranger still if Congress thought abusive or illegal the IRS's practices of making assessments against employers before or without making assessments against employees and did not correct that abuse in its major reform of the IRS in 1998 * * * ." *330 West Hubbard Restaurant Corp.* v. *United States*, 37 F. Supp. 2d 1050, 1054-1055 (N.D. Ill. 1998), aff'd, 203 F.3d 990 (7th Cir. 2000).

demand of FICA taxes under 26 U.S.C. 3121(q) are located at IRM 4.23.7.12.6 rather than IRM 4.23.7.13 (cited by respondent). See Rev. Rul. 95-7, 1995-1 C.B. 185, 186.

Under the provisions of the Manual that actually apply for this purpose, it is correct that a "notice and demand" is a prerequisite to an employer's liability for FICA taxes on unreported tips and that "the employer is not liable for its portion of the FICA taxes on those tips until notice and demand for the taxes is made to the employer by the Internal Revenue Service." Rev. Rul. 95-7, 1995-1 C.B. 185, 186 (Q&A 6).[10] This is because Section 3121(q) of the Code specifies that "such remuneration shall be deemed * * * to be paid on the date on which notice and demand for such taxes is made to the employer by the Secretary." 26 U.S.C. 3121(q).[11]

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[10] This pre-assessment notice and demand requirement of Section 3121(q) is additional to, and separate from, the notice and demand requirement of Section 6303(a). The latter statute requires the Service to provide a statement of the amount owed by any taxpayer, for any tax, "*after* the making of an assessment of a tax." 26 U.S.C. 6303(a) (emphasis added). Section 3121(q), by contrast, applies only before assessment and concerns only the employer's liability for FICA taxes on unreported tip income. See 26 U.S.C. 3121(q). Contrary to respondent's suggestion, the "procedural path" (Resp. Br. 30) for issuance of *pre*-assessment notice and demand under Section 3121(q) is obviously not identical to the "procedural path" for the issuance of *post*-assessment notice and demand under Section 6303(a).

[11] Taxes generally are due at the time the return reporting such taxes is due. 26 U.S.C. 6151(a); 26 C.F.R. 31.6151-1(a). An employer's quarterly FICA tax returns are ordinarily due on the last day of the first calendar month following the end of the quarter. 26 C.F.R. 31.6071(a)-1(a)(1); see 26 C.F.R. 31.6011(a)-1(a)(1); 26 U.S.C. 6011(a), 6071(a). Thus, an employer's liability for FICA taxes is due with the quarterly return for the quarter in which the notice and demand is made. Rev. Rul. 95-7, 1995-1 C.B. at 186 (Q&A 9).

Contrary to respondent's contention (Resp. Br. 29), however, the notice and demand required for this employer FICA assessment to proceed is simply a notice and demand for the *aggregate amount of taxes owed by the employer*, not an assessment somehow broken down by each individual employee. The Service in fact sent a pre-assessment "notice and demand for the taxes" owed by respondent (Rev. Rul. 95-7, 1995-1 C.B. at 186 (Q&A 6)), and a copy of that notice and demand is lodged in the record. J.A. 41-42. No further or different "notice and demand for taxes" is required by the agency's manual before the assessment could be made.

(ii) Even if the pre-assessment notice and demand issued to respondent had *not* complied with the Internal Revenue Manual, that would be of no consequence in this litigation. The provisions of the Internal Revenue Manual establish operating procedures for IRS employees. These procedures, however, are not binding on the IRS and confer no rights on taxpayers. *E.g.*, *First Alabama Bank, N.A.* v. *United States*, 981 F.2d 1226, 1230 n.5 (11th Cir. 1993); *Urban* v. *Commissioner*, 964 F.2d 888, 890 (9th Cir. 1992); *United States* v. *Horne*, 714 F.2d 206, 207 (1st Cir. 1983); *Einhorn* v. *DeWitt*, 618 F.2d 347, 350 (5th Cir. 1980). See also *Schweiker* v. *Hansen*, 450 U.S. 785, 789-790 (1981); *United States* v. *Caceres*, 440 U.S. 741, 752-753, 755-756 (1979). A failure of an agency employee to follow the operational guidelines set forth in the Manual does not provide a basis for a taxpayer to avoid payment of the taxes that Congress imposed in the Internal Revenue Code.

8. In litigation conducted over the last decade, the United States has consistently advocated that the Service may assess the employer portion of the FICA taxes based on reasonable aggregate estimates of unre-

ported employee tip income. Respondent nonetheless makes the implausible assertion that such aggregate assessments of the employer portion of the FICA taxes are contrary to IRS policy. Resp. Br. 25, 47. In support of this assertion, respondent cites two internal IRS memoranda written in 1996 and 1998. These memoranda describe the agency's self-imposed moratorium on aggregate assessments during the period that the issue now before this Court was being litigated in the lower courts.[12] The 1996 memorandum was issued in response to the adverse decision of the Court of Federal Claims in *Bubble Room, Inc.* v. *United States*, 36 Fed. Cl. 659 (1996). That decision was subsequently vacated by a decision of the Federal Circuit that upheld the government's position on this issue. 159 F.3d 553 (Cir. 1998). During the pendency of that appeal, the 1996 memorandum stated that aggregate assessments

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[12] These memoranda were not introduced into the record of the district court. The government was thereby deprived of any opportunity to provide explanatory affidavits or other relevant materials. See J.A. 102. Notwithstanding respondent's unsupported assertion to the contrary (Resp. Br. 47 n.28), the extra-record materials belatedly offered by respondent are entitled to no consideration at this stage of the case. Evidentiary materials that were not "filed in the district court" are not part of the "record" in the district court (Fed. R. App. P. 10(a)) and are therefore not to be included in the appendix or considered on appeal. See, *e.g.*, *United States* v. *Harris*, 542 F.2d 1283, 1308 (7th Cir. 1976), cert. denied, 430 U.S. 934 (1977); *United States* v. *Dunham Concrete Products, Inc.*, 475 F.2d 1241, 1251 (5th Cir.), cert. denied, 414 U.S. 832 (1973); *Tanner* v. *United States*, 401 F.2d 281, 288 (8th Cir. 1968), cert. denied, 393 U.S. 1109 (1969); *Jackson* v. *United States*, 131 F.2d 606, 607 (8th Cir. 1942) ("We cannot, of course, concern ourselves with anything which does not appear in the record."). See also Sup. Ct. R. 26.1-26.2 (authorizing the inclusion of "parts of the record" and "portions of the record" in the Joint Appendix).

would not be issued "[u]ntil all issues relative to this court case [were] resolved." J.A. 104. The 1998 memorandum offered similar guidance on employer FICA tax assessments in view of the fact that legislation was pending at that time to modify tip reporting agreement procedures. J.A. 106-107; see U.S. Br. 29-30.

Neither of these memoranda suggests that the IRS thought it lacked authority to make aggregate assessments. Indeed, the agency's continued litigation of that issue demonstrates the contrary. These memoranda instead reflect an orderly and temporary moratorium on such assessments while the question of the agency's authority was under consideration in the courts and before Congress. And, this self-imposed moratorium was lifted by the agency following the entry of the appellate decisions upholding the agency's assessment authority in the *Bubble Room*, *330 West Hubbard* and *Morrison Restaurants* cases. See IRS News Release IR-2000-26 (Apr. 26, 2000), *reprinted in* BNA *Daily Tax Report* at L-1 (Apr. 27, 2000).

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For the foregoing reasons and the reasons set forth in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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Solicitor General

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